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26419—25†—1

In the Supreme Court of the United States

OCTOBER TERM, 1924

EPHRAIM LEDERER, COLLECTOR OF INTERNAL REVENUE for the First District of the State of Pennsylvania, petitioner
v.
FIDELITY TRUST COMPANY

No. 184

ON CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

STATEMENT

The Fidelity Trust Company sued Lederer, collector of internal revenue, for $450, and interest, the amount paid under protest for internal revenue stamps which the collector required the trust company to attach to an issue of well-known securities, commonly called equipment trust certificates.

The District Court decided in favor of the collector, but the Circuit Court of Appeals reversed the judgment of the District Court and held that the statute did not require these instruments to be stamped. This writ of certiorari brings up that judgment for review.

The sole question is whether the equipment trust certificates are subject to stamp tax under the provisions of the Revenue Act of 1918, Act of February 24, 1919, c. 18, 40 Stat. 1057 (not the Act of 1921 as erroneously stated in the transcript of record, p. 2).

THE STATUTE

Section 1100, Title XI, of the Act provides (40 Stat. 1133):

> That on and after April 1, 1919, there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, sold, removed, consigned, or shipped, the several taxes specified in such schedule. The taxes imposed by this section shall, in the case of any article upon which a corresponding stamp tax is now imposed by law, be in lieu of such tax.

Subdivision 1, Schedule A, Title XI (40 Stat. 1135), provides:

> 1. Bonds of indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any person, and all instruments, however termed, issued by any corporation with interest coupons or in registered form,

known generally as corporate securities, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue: *Proided further*, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured.

Article 8, Regulations 55, approved February 24, 1919, provides:

> *Instruments issued by corporations in numbers, under a trust indenture, are bonds.*—Instruments containing the essential features of a promissory note, but issued by corporations in series, secured by a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and in some instances for redemption before maturity, or similar provisions, are bonds, within the meaning of the statute, whether called bonds, debentures, or notes.

THE FACTS

These equipment trust certificates were issued pursuant to the provisions of two agreements between the Fidelity Trust Company and the Interstate Railroad Company, each dated February 2, 1920, executed contemporaneously, and the one attached to the other and constituting, in effect, one agreement creating the "Interstate Railroad equip-

ment trust series C" (page 2). The first agreement appears in the record beginning at the bottom of page 2. The second agreement, which recites the first one, is set forth in the record beginning on page 9.

The first agreement purports to be a lease from the Fidelity Trust Company, as trustee, to the Interstate Railroad Company for the term of 10 years from the 1st day of February, 1920, unless sooner terminated as therein provided, of 500 steel-hopper coal cars, to be delivered at the rate of 10 to 15 a day, beginning on or about the 26th day of February, 1920. The following are the important provisions of the lease (page 3):

The lessee—that is, the railroad company—agrees to pay the lessor, the trust company, as rent and hire for the cars—

1. Half yearly on the last day of the months of January and July in each year—

(A) A sum equal to three per cent on $900,000, which sum is to be reduced from time to time by an amount equal to three per cent on such sum as the lessee shall have paid prior to said respective dates to the lessor, to be applied in reduction of the said sum, $900,000, as specified in paragraph 2 of Article 1.

(B) The reasonable expenses of the lessor in enforcing the covenants of the lease, and

(C) A sum equal to the taxes upon the property leased which the lessor may be liable to pay and any

taxes which by law may be charged against the lessor on account of payments of rentals under the lease.

2. Annually, on the last day of January in each year, for ten years, beginning the last day of January, 1920, the sum of $90,000.

3. As additional advance rental, the sum of $200,000 on the 2d of February, 1920 (page 4).

4. Lessee may on the 1st day of February or August of any year, during the continuance of the lease, pay all the rentals therein reserved and unpaid, though not yet matured, together with the premium of one per cent on the sums before mentioned under 2; whereupon the lease shall determine and the lessee shall be entitled to purchase the cars upon payment of $1 (page 4).

By Article 2 the lessee agrees to keep the cars in good order and repair at its own expense, and also to cause the cars, or any that may be substituted therefor, to be numbered, and to affix on each car a metal plate bearing thereon the words "Fidelity Trust Company, as trustee, owner and lessor"; and also to replace forthwith at its own cost any of said cars which may be destroyed; not to allow any name to be placed on any of the cars as a designation which might be interpreted as a claim of ownership thereof, provided, however, that the lessee may cause the cars to be marked with its own name or its initials or any pseudonym which it may have adopted for convenience of identification.

By Article 4th (page 5), the lessee covenants against any judgment or transfer of its rights or

interest in the equipment and against any underletting without the consent of the lessor; and that the lessor shall have the right to declare the lease terminated in case of any unauthorized sale or transfer, provided, however, that the lessee may, in its ordinary course of business, use or permit the use of the equipment upon other lines of railway, and may permit the interchange of said equipment with other railroad companies.

By Article 5th (page 5), in case of default in payment of the rental, or failure to perform any of the covenants of the lease, the lessor may declare the lease terminated; whereupon all installments of rent whether then due or not, shall at once become due and payable, and the lessor may enter and retake the equipment.

By Article 6th (page 6) it is provided that such retaking shall not be a bar to the recovery of any sums accruing thereafter as rental until such sum is realized as, with the net proceeds of sale or other disposition of the equipment, shall be sufficient for the payment in full of taxes or expenses incurred by the lessor, and all rentals provided to be paid under the lease, "it being the intention of this agreement that the lessee shall be bound at all events to pay the full rental herein specified to be paid, being relieved by the retaking of the equipment only to the extent of the net cash actually realized from the lessor by sale or other disposition of the equipment."

By Article 7th (page 6) the lessor agrees that upon the payment by the lessee of all moneys which it

agrees to pay the lessor will, upon payment of the additional sum of $1, cause the equipment to be sold, assigned, and transferred to the lessee as its absolute property; and it is further agreed that the cars are being constructed by the Pressed Steel Car Company in accordance with the specifications and under a contract approved by the lessee; that the lessor shall not be liable for delay in the delivery of the cars, nor for any default upon the part of the manufacturers, nor from any defect in the cars, "nor shall anything herein be construed as a warranty upon the part of the lessor in respect thereof, nor as a representation in respect to the value thereof." There is indorsed upon the lease (page 8) an agreement whereby the "Virginia Coal & Iron Company warrants and becomes surety to the Fidelity Trust Company, trustee, for the faithful performance by the Interstate Railroad Company of its obligations under within lease and for the payment by it to the said trustee of the rentals thereby reserved, when and as the same become due and payable."

The second agreement, dated the same day, starts by reciting the lease "bearing even date and executed contemporaneously herewith and hereto attached," and reciting that subscriptions to the amount of $900,000 have been secured through Brown Bros. & Company, bankers, to a fund to be known as "Interstate Railroad Equipment Trust, Series C," which fund is to be applied toward the payment of the purchase price of the equipment described in the

lease; and further reciting that the trustee proposes to secure to the parties subscribing to that fund the payment thereof in ten consecutive annual payments of $90,000 each (corresponding to the rentals described in Article First of the lease, page 3), with interest at the rate of 6 per cent per annum, "payment on said principal and interest to be made as herein set forth, and the evidence of the rights of the subscribers to said fund to be by certificates in the form herein set forth."

After these recitals the agreement provides:

> First. The trustee agrees that upon the execution and recording of the lease and "this agreement," and when the amount of money necessary to pay for the equipment shall have been deposited with it, it will deliver to Brown Bros. & Company nine hundred certificates in form following.

Then follows (page 10) the form of certificate. The certificate is headed:

> Total issue, $900,000. Interstate Railroad Equipment Trust, Series C. No. —, $1,000. 900 shares of $1,000 each.

This certificate, executed under seal by the Fidelity Trust Company, Trustee, certifies that the bearer is entitled to one share of $1,000 in the Interstate Railroad Equipment Trust in accordance with the provisions of the agreement between the trustee and the railroad company. The principal will be payable on the 1st day of February, 19—, upon the surrender of the certificate at the office of the trustee, and, in

the meantime, dividends will be payable as evidenced by the dividend warrants attached. The certificate is subject to call at any interest period, on payment of principal and a premium of one per cent. Both principal and dividends are payable in gold coin of the United States of the present standard of weight and fineness, but only from and out of the deferred rentals when paid as provided for in the lease, which rentals are payable to the trustee for the benefit of the holders of the certificates, to which lease and second agreement reference is made for the statement of the rights of the holders of the certificates. The additional advance rental of $200,000 provided by Article First, Section 3, of the lease shall be used in part payment for the equipment and the settlement of expenses incurred in the creation of the trust. The holder of the certificate may have it registered on the books of the trustee, to be noted on the back of the certificate.

The agreement then provides that each certificate shall bear an endorsement by the Virginia Coal & Iron Company, certifying that it has become surety to the Fidelity Trust Company for the payment by the Interstate Railroad Company of the rentals reserved in the lease. Each certificate shall have dividend warrants thereto attached in the following form:

> Due to the bearer hereof on the first day of ——, 19—, on surrender hereof at the office of Fidelity Trust Company, Philadelphia, the sum of thirty 001/00 dollars ($30.00) in

United States gold coin, being the semi-annual dividend on certificate No. —— of Interstate Railroad Equipment Trust, Series "C," payable only out of the rentals under the lease referred to in the said certificates.

FIDELITY TRUST COMPANY,
By ——— ———, *Treasurer.*

The certificates shall be numbered from one to nine hundred, inclusive, and maturity dates so arranged that ninety shall be paid each year, the maturity dates corresponding to the payments to be made by the Railroad Company under Article First of the lease.

Then follow various provisions of the kind usually found in trust agreements, providing for the issuance of temporary receipts pending the engraving of the definitive certificates, for the keeping by the trustee of a register of the holders of registered certificates, a covenant by the trustee to perform and, as far as possible, with due diligence to enforce the performance of the terms of the lease, and to apply and distribute the rentals when and as they shall have been received, first, to the payment of its necessary and reasonable expenses; second, to the payment of any taxes upon the income or property of the trust; third, to the payment of the individual warrants attached to the trust certificates; fourth, to the payment and redemption of the principal, and the usual agreement that the trustee shall not be liable or responsible for any matter or thing con-

nected with the trust except its own willful and intentional breach.

The railroad company agrees to pay the expenses of the trustee and all taxes for which the trustee may be liable or which it may be required to deduct from the principal of the certificates or the dividends thereof.

Then follows the customary default clause, which gives the trustee the right, in the event of default, to declare the principal of all the certificates due, and to enforce all the terms and the stipulations of the lease; and should the trustee take possession of the equipment it shall not be a bar to the recovery from the railroad company for the future accruing rent until such sum is realized as is sufficient for the payment in full of all taxes and expenses, accrued dividends, warrants, and principal of all the said certificates.

The agreements bear certificates showing recording in the office of the Recorder of Deeds in Philadelphia and in the office of the Clerk of Wise County, Virginia.

In brief, these agreements provide for an issue of "car trust certificates" to the amount of $900,000, bearing interest at 6 per cent payable semi-annually, with maturities of from one to ten years, redeemable at par and 1 per cent premuim, and secured by a first lien upon 500 steel cars costing $1,100,000, of which amount $200,000 was paid in cash.

The scheme is known as the "Philadelphia Plan."

ARGUMENT

The instruments in question are corporate securities within the meaning of the statute

The Government insists that equipment obligations, by whatever name called, whether issued under the Philadelphia plan or in any other form, are subject to the stamp tax under the statute already quoted, as "instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities."

Car trust certificates have long been known as a favorite form of investment security, grouped under the general term "equipment obligations." They are issued in various forms, but the underlying security is always a lien upon the rolling stock of railroads. They are classed with bonds by writers upon corporate finance.

Conyngton, in "Corporate Organization and Management" (1917), discusses them in chapter 51, entitled "Bonds," describing them, at page 441, as "car trust bonds," saying:

> Car trust or equipment trust bonds or certificates are issued by a trustee, who holds for their security equipment purchased or leased by a railroad company. * * * When the final payment is made by the railroad company, the deed of trust by which the property is held is released and the equipment becomes the property of the purchasing company.

Jones, in "Corporate Bonds and Mortgages" (3d edition of Railroad Securities, revised), discusses

them in chapter 5, section 128, with reference to their relation to mortgages containing an after-acquired property clause, and points out that nearly all the States (naming them and citing the statutes) have passed laws prescribing the conditions under which "contracts for the sale or lease of rolling stock," with a reservation of title in the vendor until full payment of the purchase price is made, shall be valid against creditors or purchasers without notes. See also Thompson on Corporations, 2d edition, Vol. III, §2689.

William H. Walker, dean of Duquesne University School of Accounts, Finance and Commerce, in "Modern Business" (Volume 11, on "Corporation Finance"), chapter 9, page 145, discusses them under the heading "Bonds Secured by Leases," and says:

> As a rule, leases serve as collateral for bonds only in the purchase of railway equipment, and especially when a closed first mortgage or the after-acquired property clause interferes with making a new direct loan against the equipment to finance its purchase. These obligations are known as car or equipment trust bonds, or car trust certificates.

After discussing the various forms in which the securities are issued, he continues (at page 147):

> Equipment trust bonds, such as the car trust certificates above mentioned, are very secure and enjoy an increasingly broad market. This is because the equipment covered by the lease is practically indispensable to the railway and can be taken from it instantly in the event of default.

The rules of the Interstate Commerce Commission require "equipment bonds, equipment notes, or car trust notes," to be included in Account No. 755 of General Balance Sheet Accounts, under the heading of "Funded debt unmatured." (See Classification of Income, Profit and Loss, and General Balance Sheet Accounts for steam railroads, prescribed by the I. C. C., issue of 1914.)

One of the latest books upon this subject is entitled "Equipment Obligations," by Kenneth Duncan, sometime Fellow in Economics in the University of Michigan, with an introduction by I. C. Scharfman, of the same university. (D. Appleton & Co., 1924.) This book traces in a most interesting manner the history of securities of this type, discusses their place in corporate finance, their investment qualities, their legal aspects, and gives some significant statistics. In the Introduction it is said (Page XXVII):

> Because of the rapid development of their use, the steady increase in their amount, they are constantly growing in importance from the standpoint of the investor. They are the chief means of financing railroad equipment, which is generally recognized as the most urgent need of the transportation system in recent years.

In Chapter II, page 23, there is a table showing the amount of these securities outstanding in each year from 1890 to 1920 and their relation to the total funded debt of American railroads, the figures,

as is stated, being based upon reports to the Interstate Commerce Commission. It appears that in 1890, the total amount of equipment obligations outstanding was $49,478,215 as against a total funded debt of $4,574,576,131, while in 1920, the figures were, respectively, $646,155,492 and $11,254,946,156. While the total funded debt, therefore, increased about two and one-half times, the equipment obligations increased about thirteen times.

The author says of the Philadelphia plan (page 16), the one here in question, that it was first used in 1868 for furnishing equipment to the Lehigh Coal and Navigation Company. The difficulty which gave rise to its use was the rule prevailing in Pennsylvania that a conditional sale of chattels was not valid against the claims of third parties, so resort was had to a contract in the form of bailment. He says (page 17):

> Such an arrangement was obviously a subterfuge, but had always been sustained by the Pennsylvania courts as valid against third parties, although in most other jurisdictions courts at first were inclined to frown upon the device and to give it no greater legal effect than if it had been a conditional sale or a chattel mortgage.
>
> It is, of course, needless to say that the device has now become so universally used and has become so thoroughly respected in the courts that there is no longer any suggestion of "subterfuge" or irregularity attaching to such transactions. The plan is now a

practical business expedient, based upon a legitimate legal fiction.

The author points out (page 227) that five States—California, Connecticut, New Hampshire, Ohio and Rhode Island—have by statute placed equipment obligations among the legal investments for savings banks (citing the statutes in an appendix).

By the terms of the Federal Control Act of March 21, 1918, c. 25, 40 Stat. 451, sections 6 and 7 (page 455), a revolving fund of $500,000,000 was provided from which advances might be made to the railroads by the President. During Federal control they were to be allowed to issue such "bonds, notes, equipment trust certificates, stock, and other forms of securities" as the President might approve. The President was authorized to purchase from the revolving fund for the United States all or any part of such securities.

By the Act of November 19, 1919, c. 116, 41 Stat. 359, provision was made for reimbursement of the United States for equipment ordered for railroads while under Federal control. The Act specifically provided for the issuance of equipment trust certificates based upon conditional sale, and authorized the President to accept them from the railroads.

Professor Duncan says (page 70) that under this Act the total amount of equipment trust obligations acquired by the United States was $346,555,750, and that the agreement with the Pennsylvania Railroad Company was "drawn upon the Philadelphia lease

plan," the others being upon the conditional sale plan (page 71).

In the New York Times of January 3, 1925, there appeared an advertisement by an investment brokerage firm which (without attempting to follow the form of typographical display) read as follows:

> For January investment. Sound bonds yielding from 3.85% to 8.19%. Government, municipal, railroad equipment trust, public utility, industrial, real estate. Write for our January list of investment suggestions covering the above, which will be forwarded upon request for Circular J–1.

By writers upon economics and finance, in legal text books, in State statutes, in Acts of Congress, by the Interstate Commerce Commission, and in the market place, therefore, these instruments are referred to and regarded as corporate securities and classed, generally, as a form of bond.

Clearly, the certificates in question come within the letter as well as the intent of the law. The subject matter embraces, among other things, various broad classes of documents, and section 1100, previously quoted, shows that the tax is levied on the issuance of the documents themselves:

> the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed.

In this section and in Schedule A the classes are indicated in the most general and least specific

terms. There is no room for fine distinctions; and the broad language—

> all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities—

affords no excuse or reason for withholding the application of the law to any form of obligation well known and universally regarded as a corporate security. It was not necessary for Congress to use the exact terms employed by the Fidelity Trust Company and the Interstate Railroad Company in describing their instruments. General language was sufficient. As stated by Mr. Justice Holmes in *Towne* v. *Eisner*, 245 U. S. 418:

> A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to circumstances and the time in which it is used.

It is insisted, however, that certificates in this particular form have distinguishing marks which remove them from the general class of bonds. It is said that they do not bear interest, as the coupons are described as dividend coupons rather than interest coupons. The difference is one of name only. It is claimed that the dividends represent payments of rental rather than interest upon money loaned; but interest is merely rental upon money, and the so-called dividends are clearly interest, and the exact amount of interest for definite periods upon

money supplied by certificate holders for the purpose of purchasing equipment.

It is claimed that the certificates should not be regarded as bonds because they provide that the dividends or rentals, by whatever name they are called, are payable by the trustee only "from and out of the deferred rentals when paid as provided for" in the lease; but a bond or certificate of indebtedness is none the less such because principal and interest are payable out of a specific fund. It is only necessary to refer to the well known class of corporate securities known as income bonds, where the payment of interest is contingent upon earnings.

These certificates are within both the letter and the spirit of the law. They are issued by a corporation. They have attached to them detachable coupons representing three per cent of the face value of the certificate, payable semiannually on definite dates, and are clearly interest coupons—call them what you will. They may be registered as to principal, and if they are not generally known as "corporate securities" then every one—investors, bankers, students, and text-book writers—is laboring under a mistake.

There are three forms of contract in common use now, whereby the creation of a lien, represented by equipment certificates, is accomplished; a chattel mortgage, a conditional sale, and a lease with an option to purchase. Usually there is a trustee who holds the title or to whom the mortgage runs. Sometimes the certificates are issued directly by the railroad company and certified by the trustee in the same

manner as mortgage bonds. Sometimes, as in the present case, the certificates are issued by the trustee. Since the passage by the States of the legislation now in force, there is practically no difference.

Professor Duncan says:

> But, in general, it is immaterial which plan is used. (Equipment Obligations, page 38.)

and at page 113, he says:

> In view of this situation, the earlier railroad equipment agreements strove to simulate the form of a bailment as faithfully as possible. The terms of the contract spoke of a "lease," "lease warrants," and "rentals." Interest coupons were called "dividend warrants." The interposition of a trustee or car trust association was calculated not only to simplify financing, but also to give greater semblance of reality to the lease arrangement, by separating the buyer and the seller still farther. The option to purchase was given a separateness by being introduced as an additional provision in the contract, independent of the other provisions, and stipulating a nominal purchase price, distinct from rental payments. These advantages are, at the present time, purely of historical interest, and, as will be demonstrated, were never of genuine value outside of those few States where courts were inclined to distinguish between conditional sales and other transactions in which the lease form was used under identical circumstances.

This court and other Federal courts, whenever instruments of this class have come before them,

have always looked beyond the particular form to the real substance of the transaction; and we think the following cases show that the form of the agreement is, for practical purposes, immaterial and taxation is certainly a most practical purpose.

In *Hervey* v. *Rhode Island Locomotive Works*, 93 U. S. 664, the locomotive company leased a locomotive engine and tender. The lease provided that the lessee should pay 10 per cent cash and the balance in three instalments. Upon completion of the payment the lessor covenanted to grant, sell, assign, transfer and convey to the lessee the property involved. The question involved was whether the contract of lease was in effect a chattel mortgage under the laws of Illinois. The court held that this was a lien in the nature of a chattel mortgage which under the laws of Illinois must be recorded within a specified time in order to preserve the contract lien. In this connection the court said, at page 672:

> In determining the real character of a contract, courts will always look to its purpose rather than to the name given to it by the parties. If that purpose be to give the vendor a lien on the property until payment in full of the purchase money, it is liable to be defeated by creditors of the purchaser, who is in possession of it. This was held in *Murch* v. *Wright*, 46 Ill. 488. In that case the purchaser took from the seller a piano at the price of $700. He paid $50 down, which was called rent for the first month, and agreed to pay, as rent, $50 each month, until the whole amount

should be paid, when he was to own the piano. The court held, "that it was a mere subterfuge to call the transaction a lease; and that it was a conditional sale, with the right of recision on the part of the vendor, in case the purchaser should fail in payment of his instalments. * * *" That case and the one at bar are alike in all essential particulars.

* * * * *

It is true the instrument of conveyance purports to be a lease, and the sums stipulated to be paid are for rent; but this form was used to cover the real transaction, as much so as was the rent of the piano in *Murch* v. *Wright*, *supra*. There the price of the piano was to be paid in 13 months, and here, that of the engine, $12,093.96, in one year. It was evidently not the intention that this large sum should be paid as rent for the mere use of the engine for one year. If so, why agree to sell and convey the full title on the payment of the last instalment?

See to the same effect *Fosdick* v. *Schall*, 99 U. S. 235, 250; *Huidekoper* v. *Locomotive Works*, 99 U. S. 258.

See also *Myer* v. *Car Co.*, 102 U. S. 1, construing an Iowa statute substantially the same as the Illinois statute.

In *Heryford* v. *Davis*, 102 U. S. 235, a manufacturer of railroad cars hired to a railroad company certain cars for a specified time, with the right and privilege at any time to purchase the cars upon the payment of a stipulated sum. The court in determin-

ing whether or not the agreement was a bailment, conditional sale, or an absolute sale, subject to recordation under the laws of Missouri for the perfection of the lien reserved therein, held that the contract was not a bailment or a conditional sale, but that under it the ownership of the cars passed to the railroad company, and therefore to protect the property from seizure by its creditors the lessor should have recorded the instrument as prescribed by the laws of Missouri for recording mortgages or deeds of trust of personal property. In this connection the court says, at pages 243–246:

> What, then, is the true construction of the contract? *The answer to this question is not to be found in any name which the parties may have given to the instrument, and not alone in any particular provisions it contains, disconnected from all others, but in the ruling intention of the parties, gathered from all the language they have used. It is the legal effect of the whole which is to be sought for. The form of the instrument is of little account.*
>
> Though the contract industriously and repeatedly spoke of loaning the cars to the railroad company *for hire*, for four months, and delivering them for use *for hire*, it is manifest that *no mere bailment for hire was intended.*
>
> * * * * *
>
> No part of the money was to be returned to the railroad company in any event, not even if the cars should be returned. On the contrary, it was stipulated expressly that if the manufacturing company should elect to

take the cars into their own possession, which they reserved the right to do in case of default of payment of the notes, the property should be sold, and of the net amount realized from the sale, so much as should be needed to make the amount remaining due and unpaid on the promissory notes, with the interest that might have accrued thereon, should be retained by the manufacturing company, and the surplus, if any, should be paid over to the railroad company.

What was this but treating the notes given for the sum agreed to be the price of the cars as a debt absolutely due to the vendors? What was it but treating the cars as a security for the debt?

* * * Notwithstanding the efforts to cover up the real nature of the contract, its substance was an hypothecation of the cars to secure a debt due to the vendors for the price of a sale. (Italics supplied.)

In *Harkness* v. *Russell*, 118 U. S. 663, the Supreme Court reviewed the law of chattel mortgages, conditional sales and leases in the nature of conditional sales, discussing the laws of the various States, including Pennsylvania. (See page 676.) It is an elaborate opinion and discusses the cases above cited.

See also *Kneeland* v. *American Loan & Trust Company*, 136 U. S. 89; *Chicago Railway* v. *Merchants Bank*, 136 U. S. 268.

In *McGourkey* v. *Toledo & Ohio Central Railway Company*, 146 U. S. 536, the Supreme Court held

that car trust agreements, although in the form of leases, must be treated as mortgages. In this connection the court, at page 568, says:

> As before observed, contracts of this description for the purpose of leasing the rolling stock are by no means uncommon, and it is not improbable that this syndicate may have taken for granted that the raising of the money by car trust certificates issued to themselves or to those in confidential relations with them was but another mode of accomplishing the same result. The law, however, characterizes the transaction as a constructive fraud upon the mortgagee. (In this case the directors of the railroad company held the certificates.)
>
> We think the court below was correct in holding that these leases, so far as they are a security at all, must be treated as mortgages. Reading between the lines of these instruments, it is quite evident that no ordinary letting of property for a fixed rental was contemplated, but that the retention of title by the lessor was intended for the mere security for the payment of the purchase-money. Thus by lease A there was to be a payment of a gross sum of $100,000 upon the delivery of the property, and an annual rental of $40,000, with interest at 8 per cent, with a further provision that if such payments were promptly made for the ten years specified, the property should belong to the railroad company without further conveyance. In case of default, however, the lessor made no provision for resuming

his title to the property, but merely for the resumption of possession for the purpose of sale, as in an ordinary foreclosure of a mortgage. All these provisions are inconsistent with the idea of an ordinary lease of personal property.

See also *Central Trust Company* v. *Groome*, 2 U. S. App. 95, *Central Trust Company* v. *Hiawassee*, 2 U. S. App. 1, and *Frank* v. *Denver & R. G. Ry. Co.*, 23 Fed. 123.

CONCLUSION

In form and in substance, these instruments are corporate securities, and are so regarded by legislatures and by courts; by standard authorities and in common speech, and are within the provisions of the revenue act in question.

The judgment of the Circuit Court of Appeals should be reversed.

JAMES M. BECK,
Solicitor General.

ALFRED A. WHEAT,
Special Assistant to the Attorney General.

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